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Intangibles in a transfer pricing context: Reflections on the Ninth Circuit's decision in *Amazon.com, Inc. v. IRS Commissioner*

A unanimous decision by the US Court of Appeals for the Ninth Circuit on 16 August 2019 affirmed the decision of the US Tax Court in ***Amazon.com, Inc. v. IRS Commissione***r, 148 TC 108 (2017). The court held that intangible assets under the US transfer pricing regulations under Section 482 in effect in 2005 and 2006 do not encompass residual-business assets such as the value of workforce in place, goodwill, going concern value and other similar components that are not discrete items of intellectual property. The Ninth Circuit, using 'traditional tools', favoured Amazon's interpretation and definition of 'intangibles' as 'limited to independently transferable assets'.

Background and case specifics

Amazon set up a subsidiary in Luxembourg ('Lux') as a holding company to ensure lower tax liabilities for the bulk of Amazon's European business. In 2005 and 2006, Amazon transferred to Lux three groups of intangible assets through a cost-sharing arrangement (CSA) pursuant to applicable regulations:

- Website-related technology
- Marketing intangibles, including trademarks, trade names and domain names relating to the European business
- Customer lists and related customer information.

Under the terms of the CSA (and under the applicable transfer pricing regulations), Lux had to make an upfront 'buy-in payment' for the pre-existing intangible property (IP). Amazon determined a buy-in payment of $255 million to Lux based on an estimated 7-year life for the transferred intangibles. Amazon did not include the value of any residual-business assets in the determination of the buy-in payment.

The IRS performed its own calculation: applying a methodology that identified all non-routine/non-benchmarkable income as the income associated with the transferred IP, they valued the buy-in at $3.6 billion. The IRS argued that the definition of intangibles under the 1994 transfer pricing regulations was broad and thus did not specifically exclude residual-business assets from the scope of the buy-in requirement.

For the privilege of building out Amazon throughout Europe, the IRS required Lux to pay for Amazon's US IP, including 'residual-business assets' such as the value of Amazon's workforce in place, culture of innovation, going concern value, goodwill and growth options.

Amazon disagreed, and petitioned the Tax Court.

The core argument of the case and its subsequent appeal stems from each party's interpretation of what qualifies as an intangible under Section 1.482-4(b) and as referenced in the cost-sharing regulations (Section 1.482-7A(a)(2)) at the time of Amazon's 2005–2006 CSA. Amazon argued that the IRS's calculation of the buy-in payment included residual items (e.g., workforce in place, going concern value, goodwill and certain 'growth options' such as company culture) that were outside the scope of what constitutes an intangible as defined in Section 1.482-4(b).

On 23 March 2017, the Tax Court, in a landmark decision, sided with Amazon and opined that the IRS's determination of the cost-sharing buy-in payment was arbitrary, capricious and unreasonable, and agreed with Amazon that residual-business intangibles were not subject to the buy-in requirements at the time of Amazon's 2005–2006 CSA.

However, the IRS took the matter to the Ninth Circuit, arguing that the Tax Court's interpretation of Section 1.482-4(b) conflicted with the overall purpose of the arm's-length standard and that its own interpretation of 'intangibles' was supported by the Tax Cuts and Jobs Act (TCJA).

On 16 August 2019, the Ninth Circuit issued its opinion in favour of Amazon.

The Amazon case has far-reaching implications for many multinational enterprises (MNEs) with an abundance of IP and CSAs going back more than a decade

Key take-aways

Definition of 'intangibles' versus the valuation of intangibles

The Ninth Circuit was laser focused on one key issue: Did Treas. Reg. § 1.482-4(b), which was in effect for this case, require Amazon to include the value of residual-business assets in its buy-in valuation?

The IRS argued that the arm's-length standard itself means that residual-business assets are compensable because 'it is undisputed that a company entering into the same transaction under the same circumstances with an unrelated party would have required compensation'.

The Ninth Circuit panel addressed that argument in a footnote, holding that the IRS's argument 'misses the mark' and that while the arm's-length standard 'governs the valuation of intangibles, it doesn't answer whether an item is an intangible'.

The implication of the Ninth Circuit's statement is that, without showing that the transfer within the CSA was done through a limited licence that is the substantive equivalent of a sale of the business, the IRS cannot characterise the assets transferred as if the licence transfer were a sale. The key point in the Ninth Circuit's analysis involved recognition that the transfer of assets in a CSA is not necessarily the economic equivalent of a sale of business.

Cost-sharing regulations – timing matters

The Ninth Circuit pointed out that its opinion interprets the definition of 'intangible property' under Treas. Reg. 1.482-4(b) promulgated in 1994 and 1995, and not the subsequently issued 2009 regulations or the statutory amendment introduced with the TCJA in 2017.

Temporary cost-sharing regulations were issued by the US Treasury to replace the 1994 and 1995 regulations, and in 2017 Congress amended the definition of intangible property as part of the TCJA. The temporary regulations effectively expanded the definition of intangibles for cost-sharing purposes to include residual assets such as going concern value and goodwill. The TCJA expanded the definition of intangibles in Section 482 to include residual-business assets when such intangibles are transferred to a related party. Thus, if the question is: 'What are intangibles for the purposes of determining what a transferee must pay for?' the newly expanded definition would be applied, consistent with the IRS's attempt to retroactively expand that definition. However, where a transfer would not, at arm's length, include such intangibles, then the transferee should not be required to pay for them.

The Ninth Circuit also noted that the cost-sharing regulations in effect in 2005 and 2006 identified intangibles that were the product of research and development efforts, which indicated that the regulations contemplated a meaning of 'intangible' that excluded items that are generated by earning income, not by incurring deductions, such as goodwill and going concern value.

The Ninth Circuit's opinion is limited to issues arising under the 1995 cost-sharing regulation. The subsequent cost-sharing regulations replaced the reference to buy-in payment with the concept of a platform contribution transaction, which includes any resource, capability or right that is reasonably anticipated to contribute to developing cost-shared intangibles. The TCJA amended the definition of intangible property to include workforce in place, goodwill and going concern value. It remains unclear how courts might decide a similar case involving a post-2009 transaction. Nonetheless, US practitioners and taxpayers alike should familiarise themselves with this case because its consequences for the relevant time period are significant.

Implications going forward

The Amazon case has far-reaching implications for many multinational enterprises (MNEs) with an abundance of IP and CSAs going back more than a decade, and that took similar approaches to the definition of intangibles and the determinations of buy-ins when they entered into (or augmented) similar CSAs. Many MNEs with similar IP structures as Amazon and CSAs established between 1994 and 2009 may breathe a sigh of relief. However, the definition of intangibles has changed post-2009 and post-2017, and this means certain IP structures face greater scrutiny and litigation than in the past. The Amazon case will have a large impact on

the scope of the IRS's discretion in making adjustments based on its interpretation of broad language within the US Tax Code. Not only will the IRS be emboldened, but the US courts will likely be less forgiving for post-2017 structures.